SUPREME COURT, U. S.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1961.

No. 186

BANKERS LIFE AND CASUALTY COMPANY,
Petitioner,

vs.

BELLANCA CORPORATION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

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THE GUNTHROP-WARREN PRINTING COMPANY, CHICAGO

INDEX.

	PAGE
Table of Authorities	ii
Opinions Below	1
Jurisdiction	2
Questions Presented	2
Statutes Involved	3
Statement of the Case	4
Reasons for Granting the Writ	11
Conclusion	17

Appendices:

A. Opinion of District Court, Dated March 3, 1959	A-1
B. Opinion of District Court, Dated September 16, 1959	B-1
C. Opinion of District Court, Dated June 22, 1960	C-1
D. Opinion of Court of Appeals, Dated April 6, 1961	D-1
E. Texts of Relevant Statutes	E-1

Table of Authorities.

Cases.

Blau v. Lehman, 81 S. Ct. 1048 11

Goldenburg v. Bache and Company, 5 Cir., 279 F. 2d 675, 678, 681 ..... 14, 15

Kaiser-Frazer Corp. v. Otis & Co., 2 Cir., 195 F. 2d 838, 344 U. S. 856, 97 L. Ed. 664, 73 S. Ct. 89 16

Kelly v. Kosuga, 358 U. S. 516, 519, 521 ..... 12, 13, 14

Northern Securities Co. v. United States, 193 U. S. 197, 400, 24 S. Ct. 436, 468 17

Sola Electric Co. v. Jefferson Electric Co., 317 U. S. 173, 176-177, 63 S. Ct. 172, 173-174, 87 L. Ed. 1188 .. 12

D. R. Wilder Mfg. Co. v. Corn Products Refining Co., 236 U. S. 165, 35 S. Ct. 388, 59 L. Ed. 520 13

Statutes.

28 U. S. C. Section 1254(1) 2

The Securities and Exchange Act of 1934, Section 16(a) and (c), Section 78p of Title 15, U. S. C. A. .. 2, 3, 6

The Securities and Exchange Act of 1934, Section 29(a) and (b), Section 78cc(a) and (b) of Title 15, U. S. C. A. 2, 3, 7, 8, 12, 15

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Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit, entered in the above cause on April 6, 1961.

CITATIONS TO OPINIONS BELOW.

Three opinions were rendered in the United States District Court for the Northern District of Illinois: each is unreported. The first, a memorandum opinion of District Judge Philip L. Sullivan, is printed in Appendix A hereto. The second opinion, by the same Judge, is contained in Appendix B hereto. The third, by Judge Fred L. Wham is printed in Appendix C. The opinion of the Court of

Appeals, printed in Appendix D hereto, is reported in 288 F. 2d at 784.

JURISDICTION.

The judgment of the Court of Appeals was entered on April 6, 1961. Rehearing was denied April 28, 1961. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254(1).

QUESTIONS PRESENTED.

Bellanca Corporation, Respondent here, filed suit against Bankers Life and Casualty Company, Petitioner, seeking four million dollars as the price or value of shares of stock of a corporation sold by it to petitioner. Petitioner raised affirmative defenses showing that the stock in question was listed on a national exchange; that Respondent owned in excess of 10% of the issued and outstanding shares so that it was an "insider"; that the contract of sale was violative of Section 16 of the Securities and Exchange Act of 1934 in that all of the stock sold was not owned and in any event was not delivered within 20 days so that under Section 29 of the Act all of Respondent's rights arising out of the transaction were void.

This defense, in the sequence of judicial decision, was avoided and eventually judgment was rendered against petioner in the amount of one and a quarter million dollars, first, by the holding that petitioner was estopped to raise the defense; secondly, by a claim that the contract was divisible, and, in any event, did not apply to transactions not taking place on an exchange; and, by the Court of Appeals, on the basis that the violation was irrelevant despite the plain language of the statute.

This case therefore raises significant questions concerning the effect to be given the explicit statutory directive embodied by Congress in Section 29 of the Securities and

Exchange Act of 1934 as applied to the persons and matters governed by the "insiders" section of that Act (Section 16). These questions are:

(1) Is Section 16 of the Securities and Exchange Act of 1934, Section 78p of Title 15 U. S. C. A., violated by a contract for the sale of shares of stock of a corporation listed on a national exchange where the seller is an "insider" and does not own the full number of shares sold?

(2) Is Section 78p of Title 15 U. S. C. A. violated by a contract for the sale of shares of stock of a corporation listed on a national exchange where all of the shares covered by the contract, if owned, are not delivered within the time period prescribed by the Securities Act of 1934?

(3) May recovery be had for the value of shares delivered in partial performance of a contract violating the Securities Act of 1934, where the Act, Section 29 of the Securities and Exchange Act of 1934 (78cc(b) Title 15 U. S. C. A.) provides that every contract involving a violation of the Act shall be void as regards *any* rights of a violator?

(4) Whether state law governs the rights of a violator of the Securities and Exchange Act of 1934 rather than the Act itself?

STATUTES INVOLVED.

The Statutes involved are Sections 16(a) and (c) and Section 29(a) and (b) of the Securities and Exchange Act of 1934 (§ 78p, sub-paragraphs (a) and (c) and § 78cc, sub-paragraphs (a) and (b) of Title 15 U. S. C. A.). These are printed in Appendix E.

STATEMENT OF THE CASE

On May 8, 1956, Bankers Life and Casualty Company (hereinafter referred to as Bankers) entered into a contract with Bellanca Aircraft Corporation (subsequently known as Bellanca Corporation and hereinafter referred to as Bellanca). By the terms of this contract, Bellanca was obliged to deliver 51% of the issued and outstanding common stock of Automatic Washer Company (hereinafter referred to as Automatic). This was a minimum of 1,112,500 shares which Bellanca represented in the contract as owned by it. 500,000 shares of Automatic were delivered to Bankers, pursuant to the contract, upon its execution. The remainder of the shares were to be delivered within a 90 day period (the contract is set forth in full App. 31-42).

At the time of execution of the contract, Bankers was to and did supply Bellanca with certain commitments to lend in excess of Five Million Dollars on the security of the properties of certain corporations, the stock of which corporations was held by Bankers and which was to be transferred to Bellanca in exchange for the Automatic stock.

These commitments were to be used by Bellanca to finance the building of a tanker by a shipbuilding company (App. 361). The time of transfer of the shares of stock in the various corporations to Bellanca was not stated in the contract.

The ninety day period for the delivery of the balance of Automatic stock passed. The date of delivery set by the contract was August 8, 1956 (App. 31, 33). On that date, Bankers sent Bellanca a letter informing Bellanca that, because of Bellanca's failure to perform its end of the contract, Bankers declared the contract terminated and elected to retain the earnest deposit of stock (App. 43).

On September 5, 1956, Bankers received a letter from Bellanca's lawyers, replying to its August 8th letter, demanding performance of the contract on or before September 14, 1956 and directing Bankers not to exercise "any incidents of ownership" over the 500,000 shares of Automatic until it had performed the contract (App. 222-223).

Shortly after receipt of this letter, on September 12, 1956, Bankers filed a complaint in which Bellanca was named defendant, in the Circuit Court of Cook County, seeking a declaratory judgment as to the ownership of the 500,000 shares of Automatic stock received by it under the agreement (App. 13-14). It was this case, with subsequent amendments in the pleadings, which was removed to the District Court on the basis of diversity of citizenship, resulting ultimately in the judgment therein and this appeal.

Prior to trial of the case, Bellanca had filed a six count amended counterclaim (App. 69-103, Counts I through IV; App. 151-152, Count V; App. 234-236, Count VI). While these counts were pending, Bankers filed a motion for a summary judgment on each of the counts applicable to it (App. 184-185, 237).

The legal basis for the motion had been previously expressed in the affirmative defenses pleaded in answer to Bellanca's counter-claims. As set forth in Bankers' answer to Count VI (App. 240-242) this defense is as follows:

> 1. That Bellanca Corporation, counter-plaintiff herein, before and at the time of entering the contract herein sued upon, was directly or indirectly the beneficial owner of more than ten percentum (10%) of the common stock of Automatic Washer Company.
>
> 2. That the said common stock of Automatic Washer Company was at the time described registered on a national securities exchange, to-wit: the Midwest Stock Exchange.
>
> 3. That, by the terms of the contract herein sued upon, Bellanca Corporation agreed to sell and Bankers

Life and Casualty Company agreed to buy 1,112,500 shares of the common stock of Automatic Washer Company, plus an additional number of shares necessary to equal, when added to the aforesaid 1,112,500 shares, fifty-one percent (51%) of the issued and outstanding shares of Automatic Washer Company, including, as issued and outstanding, those shares of the Corporation subject to outstanding options.

4. That on August 8, 1956, there were outstanding options granting certain individuals the right to purchase from Automatic Washer Company 159,000 shares of common stock of said Corporation.

5. That at the time of the contract, Bellanca Corporation was the owner of only 715,000 shares of Automatic Washer Company.

6. That the contract sued upon was made and entered into as of the 8th day of May, 1956, and the contract further provided for its performance within ninety (90) days of said date.

7. That, in fact, there was no delivery against the sale as provided by said contract within the twenty (20) day period required by law or within any other period of time.

8. That Title 15, § 78p(c) U. S. C. A., being § 16 of the Securities and Exchange Act of 1934, provides as follows:

> "(c) It shall be unlawful for any such beneficial owner, director, or officer, directly or indirectly, to sell any equity security of such issuer (other than an exempted security), if the person selling the security or his principal (1) does not own the security sold, or (2) if owning the security, does not deliver it against such sale within twenty days thereafter, or does not within five days after such sale deposit it in the mails or other usual channels of transportation; but no person shall be deemed to have violated this subsection if he proves that notwithstanding the exercise of good faith he was unable to make such delivery or deposit within such time, or that to do so would cause undue inconvenience or expense."

9. That Title 15, §78cc (a) and (b) U. S. C. A., being §29 (a) and (b) of the Securities and Exchange Act of 1934, provides as follows:

> "(a) Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void.
>
> "(b) Every contract made in violation of any provision of this chapter or of any rule or regulation thereunder, and every contract (including any contract for listing a security on an exchange) heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this chapter or any rule or regulation thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule, or regulation: Provided, (A) That no contract shall be void by reason of this subsection because of any violation of any rule or regulation prescribed pursuant to paragraph (2) or (3) of subsection (c) of Section 780 of this title, and (B) that no contract shall be deemed to be void by reason of this subsection in any action maintained in reliance upon this subsection, by any person to or for whom any broker or dealer sells, or from or for whom any broker or dealer purchases, a security in violation of any rule or regulation prescribed pursuant to paragraph (1) of subsection (c) of section 780 of this title, unless such action is brought within one year after the discovery that such sale or purchase involves such violation and within three years after such violation."

> 10. That as a result of the facts as aforesaid and the statutory provisions here recited the contract sued upon is illegal, void, and unenforceable; that Bellanca Corporation has no rights thereunder; that further as a result of said violations Bellanca Corporation enters this Court with unclean hands.

The factual basis for the allegations made in Bankers' motion is found in Bellanca's answers to interrogatories propounded by Bankers (App. 53-56, 172-176); a stipulation of fact entered into between the parties (App. 232-234); and the deposition of Sydney Albert, President of Bellanca at the time the contract in litigation was entered into (App. 109-150). It was established that at the date of the contract, Bellanca owned only 900,000 shares of Automatic (App. 233). 715,000 shares stood in its own name and 185,000 shares were held in the name of Sydney Albert and two brokerage houses (App. 233). It was also established, by stipulation, that Bellanca's position that it was "owner" of sufficient shares to meet its commitment was based upon the inclusion of the shares of stock owned by Sydney Albert. No books or records supported Bellanca's "interest" in this stock, if any.

The undisputed and undisputable facts shown by the record at the time of Bankers' motion for summary judgment showed that Bellanca was not the owner of the shares it promised to exchange. On the face of the contract sued upon, and indeed on the face of all the pleadings of both Bankers and Bellanca was the further fact that the contract provided for the further delivery of the balance of the shares within 90 days and that this delivery had not been made and was never made.

The District Court Judge denied Bankers' motion for summary judgment and entered a memorandum opinion explaining his disposition of the motion (Appendix B). The Court did not reach the merits of the motion, concluding

that, since Bankers had filed a complaint affirming its right to keep the 500,000 shares of Automatic and alleging a breach of the contract, it was estopped from denying its invalidity.

To eliminate the claimed estoppel, Bankers subsequently, on its own motion, dismissed its complaint (App. 264-268), on the condition that the dismissal should not bar it from maintaining the defenses previously asserted.

Bellanca also on the eve of trial dismissed Counts I to IV inclusive of its counterclaim (App. 269). The case then went to trial only on Counts V and VI of Bellanca's counterclaim.

On the trial, Bellanca recovered a judgment of $1,250,000 (App. 503) being the market value as of August 8, 1956 of the Automatic shares retained by Bankers (App. 273). In addition, the trial court allowed interest at the legal rate from August 8, 1956 to the date of judgment.

The trial judge in ruling upon substantially the same facts as those set forth for Judge Sullivan on the motion for summary judgment, concluded that the contract was not void because the transaction did not take place on an Exchange (App. C). He further concluded that, even if the contract was void, Bankers was liable for the reasonable value of the stock (App. C).

The Court of Appeals in its turn did "not deem it necessary * * * to review the findings of fact or conclusions of law of the District Court." (Appendix D, p. D-5.) The Court proceeded to dispose of the appeal on the basis that Section 29 of the Securities and Exchange Act of 1934 rendered void only the *contract rights* of the party in violation.

From this premise and the further premise that the rights of the party not in violation remain unimpaired, the Court of Appeals drew the conclusion that the duties cor-

relative to the rights of the innocent party require payment in the present situation despite the statutory voiding of the violator's rights.

This attempted explanation was coupled in the Court of Appeals' opinion with the further statement (Appendix D, p. D-6):

> "Whether the seller's rights under the contract have been voided by § 78cc(b), or have become unenforceable because of its breach of the contract, the rights of the purchaser are to be measured by the law of the jurisdiction involved. Here the contract was made in Illinois. Bankers' election to retain the shares delivered was made in Illinois. The law of Illinois governs."

After these attempts to explain its position, the Court of Appeals, in apparent recognition of the analytical shortcomings of its opinion, escaped to the general (Appendix D, p. D-9):

> "Whatever difficulties may exist in accommodating abstract and formal concepts of contract law to the formulation of the rule evolved and recognized by the cases and authority above cited, and applied in Illinois, should be resolved by the 'overriding general policy, as Mr. Justice Holmes put it, "of preventing people from getting other people's property for nothing when they purport to be buying it".' *Kelly* v. *Kosuga*, 358 U. S. 516, 520-521."

REASONS FOR GRANTING THE WRIT.

1. The Court of Appeals in the Instant Case Has Decided an Important Question of Federal Law Which Has Not Been, But Should Be, Settled by This Court.

The importance of the Securities and Exchange Act of 1934 and its correct interpretation needs no emphasis here. This Court, as recently as April 24, 1961, in granting certiorari in *Blau* v. *Lehman*, 81 S. Ct. 1048 implicity has recognized the general importance of the statutory proscriptions governing the actions of those deemed "insiders" under Section 16 of the Act.

This interest should extend to the remaining subparagraphs of that Section which are here involved. While the Court of Appeals stated that it was not necessary to pass on the question of whether or not Section 16(c) was in fact violated, the record is clear that violations both as to lack of ownership and delivery did occur.

On this posture of the case, the importance of a fair and correct reading of Section 29 is apparent. It is difficult to say that the Court of Appeals has misread that section for, in its opinion, the Court appears to refuse to construe the statutory language. Yet, the effect of the Court's opinion is to establish a construction of the statute which effectively negatives its plain, announced purpose. That purpose, in the language of the statute, is to "void" the "rights" of any person making or engaging in the performance of a contract in violation of the Act.

To reason, as did the Court of Appeals, that an innocent party's *rights* require the possessor of those rights to respond in damages to the wrongdoer, the rights of which, by statute, are void, would, absent this Court's grant of certiorari, leave this opinion on the books as the only judicial interpretation of these important statutes.

This interpretation established by indirection suffers not only from its analytical shortcomings but also marks a radical departure from guiding principles furnished by this Court's previous expressions relative to the defense of illegality.

The Court of Appeals has decided, despite the language of Section 29 of the Act which provides that a contract made or performed in violation thereof shall be void "as regards the right of any person who * * * shall have made or engaged in the performance of any such contract," that a violation of the Act "is without material legal effect." The Court went on to hold that the *rights* of the petitioner, purchaser of the shares of stock involved, were to be "measured by the law of the jurisdiction involved."

By an inversion of logic and by semantic error, the Court of Appeals proceeded then to illustrate that, under Illinois law, the "rights" of the purchaser referred to were, in the context of this case, the "*right*" to respond in damages to the extent of a million and a quarter dollars, to the violator of the Securities and Exchange Act.

As one of the aids in this extraordinary analysis, the Court cited and quoted the opinion in *Kelly* v. *Kosuga*, 358 U. S. 516, while overlooking the plain purport of the case and the cases cited therein. There, at page 519, this Court reaffirmed:

> "* * * State law governs in general the rights and duties of sellers and purchasers of goods, * * * the effect of illegality under a federal statute is a matter of federal law * * *."

The opinion cited quoted *Sola Electric Co.* v. *Jefferson Electric Co.*, 317 U. S. 173, 176-177, 63 S. Ct. 172, 173-174, 87 L. Ed. 1188:

> "It is familiar doctrine that the prohibition of a federal statute may not be set at naught, or its benefits denied, by state statutes or state common law rules.

In such a case our decision is not controlled by *Erie Railroad* v. *Tompkins*, 304 U. S. 64, 58 S. Ct. 817, 82 L. Ed. 1188, 114 A. L. R. 1487. There we followed state law because it was the law to be applied in the federal courts. But the doctrine of that case is inapplicable to those areas of judicial decision within which the policy of the law is so dominated by the sweep of federal statutes that legal relations which they affect must be deemed governed by federal law having its source in those statutes, rather than by local law. *Royal Indemnity Co.* v. *United States*, 313 U. S. 289, 296, 61, S. Ct. 995, 997, 85 L. Ed. 1361; *Prudence Realization Corp.* v. *Geist*, 316 U. S. 89, 95, 62 S. Ct. 978, 982, 86 L. Ed. 1293; *Board of Com'rs of Jackson County* v. *United States*, 308 U. S. 343, 349, 350, 60 S. Ct. 285, 287, 288, 84 L. Ed. 313; *cf. O'Brien* v. *Western Union Telegraph Co.*, 1 Cir., 113 F. 2d 539, 541. *When a federal statute condemns an act as unlawful the extent and nature of the legal consequences of the condemnation, though left by the statute to judicial determination, are nevertheless federal questions, the answers to which are to be derived from the statute and the federal policy which it has adopted. To the federal statute and policy, conflicting state law and policy must yield.* Constitution, Art. VI, cl 2; *Jacobin* v. *Atlas Exchange Nat. Bank*, 295 U. S. 209, 55 S. Ct. 674, 79 L. Ed. 1393; *Deitrick* v. *Greaney*, 309 U. S. 190, 200, 201, 60 S. Ct. 480, 484, 485, 84 L. Ed. 694." (Italics supplied.)

Returning to the *Kelly* case, it is of utmost importance that the result in that case was predicated solely on the basis that the Sherman Act does not provide for the avoidance of private contracts. Describing the *Corn Products* case (*D. R. Wilder Mfg. Co.* v. *Corn Products Refining Co.*, 236 U. S. 165, 35 S. Ct. 388, 59 L. Ed. 520) this Court in *Kelly* noted:

> "The Court observed that the Sherman Act's express remedies could not be added to judicially by including the avoidance of private contracts as a sanction."

Again in the *Kelly* case, the Supreme Court (at 521 of the U. S. Report) explained:

> "Supplying a sanction for the violation of the Act, *not in terms provided* and capricious in its operation * * * is avoided by treating the defense as so confined."

The "defense as so confined" is the confining of the defense of illegality to those cases where the failure to recognize the defense would encourage the illegal conduct. Here, apart from the specific provisions of the Securities and Exchange Act of 1934, the "short" sale in a falling market by an "insider" would be encouraged even apart from the plain proscriptions of the Act.

Under this Court's decisions then, federal law and federal policy govern. Whether the federal policy requires avoidance of plaintiff's rights here is the issue. The issue cannot, under these cases, be avoided, as attempted by the Court of Appeals, by reference to state law, especially state law which has nothing to do with the defense of illegality. Federal law governs. Its interpretation is the crucial issue on this appeal.

Certiorari should therefore be granted to insure that Federal law as expressed in Section 29 of the Securities and Exchange Act of 1934 govern this situation.

2. The Court of Appeals, in the Instant Case, Has Decided the Matter at Hand in Conflict With the Decisions of Courts of Appeal Dealing With the Same Subject Matter.

It is true that, as a case of first impression, no decision of a Court of Appeals can be said to be in direct conflict with the decision herein. However, the cases closest in point dictate a result squarely contrary to that arrived at herein.

Goldenburg v. *Bache and Company*, 5 Cir., 270 F. 2d

675, was cited to the Court of Appeals and distinguished on this basis, "the application of §78cc (b) was not reached because the action was not commenced within the period of limitations." Yet a reading of the case clearly shows that the result was not so circumscribed.

The facts revealed that in the transactions under examination, there had occurred violations of the Act and the regulations enacted pursuant thereto. The plaintiff, although a person not bound by the Act, was refused relief however because of the running of the limitations contained in the Act.

On the counterclaim, although the facts revealed that the liquidation of the plaintiff's account left a deficiency of $3,212.00, Bache & Co. (a party bound by the Act as Bellanca is in the case at bar) was refused any recovery.

The Court, at page 678, referred to Section 29(b) (15 U. S. C. A. 78cc(b)) which is the very section relied upon by Bankers in this action:

> "The provisions of 15 U. S. C. 78cc(b) provides that every contract made in violation of any provision of Chapter 2B of Title 15, U. S. C., or of any rule or regulation thereunder, the performance of which involves the violation of any provisions of the aforesaid chapter or any rule or regulation thereunder, shall be void, as regards the rights of any person who, in violation of any such provision, rule or regulation shall have made or engaged in the performance of any such contract."

The Court then stated at page 681:

> "As to the counterclaim of Bache and Company, an additional clear answer is that Bache and Company cannot recover from Mrs. Goldenberg any claimed indebtedness resulting from its own violations of the statute and regulation.
>
> "The district court properly left the parties where it found them, and its judgments are affirmed."

In effect Bache & Company by violating the margin requirements of the Act loaned Mrs. Goldenberg the money they sought to recover. They claimed that she was "indebted" to them just as Bellanca alleged in Paragraph 8 of Count V and Paragraph 9 of Count VI that Bankers was indebted to it.

It is certainly true that the Court of Appeals in *Goldenberg* did state that the statute of limitations applied; however, since it is far from clear that any applicable statute of limitations did bar this claim (and certainly none contained in the Securities and Exchange Act of 1934), the "additional clear answer" stated by the Court there was a required answer, and not dictum.

Kaiser-Frazer Corp. v. *Otis & Co.*, 2 Cir., 195 F. 2d 838, cert. den. 344 U. S. 856, 97 L. Ed. 664, 73 S. Ct. 89, was also cited by the petitioner and *distinguished* by the Court here on the basis that it "involved an attempt by the party in violation to enforce the contract."

Accepting this description, petitioner is frankly unaware of the distinction. Petitioner is not the "party in violation." Bellanca is. Bellanca sued alleging the execution of the contract, the partial delivery "in accordance with the terms of said contract," the retention of the shares of stock, and claimed that petitioner was indebted to it as a result to the amount of Four Million Dollars (App. 151-156).

In another count, the same recitations were made (App. 234-236). The only variation was that the claim requested the reasonable value of the shares delivered. This reasonable value was also alleged to be Four Million Dollars.

The contract forms, then, the nexus of any liability. No duty of petitioner to Bellanca existed without proof of and reliance on the contract. Both in pleading and in proof, Bellanca relied upon its contract, a contract under which, by statute, its rights were void.

In essence, then, the decision in the present case is squarely opposed to the *Kaiser-Frazer* case.

In assessing legal rights, it should make no difference whether the claim is for damages as in *Kaiser-Frazer*, for sums advanced on a client's behalf as in *Goldenberg*, or for payment of shares delivered as in the instant case. In each case allegedly there was an invasion of legal rights or, conversely, an alleged legal duty to respond with payment. Only in this case have those rights been recognized in the face of the statutory policy; only in this case has the legal duty been maintained.

CONCLUSION.

> "Great cases, like hard cases, make bad law. For great cases are called great, not by reason of their real importance in shaping the law of the future, but because of some accident of immediate overwhelming interest which appeals to the feelings and distorts the judgment. These immediate interests exercise a kind of hydraulic pressure which makes what previously was clear seem doubtful, and before which even well settled principles of law will bend. What we have to do in this case it to find the meaning of some not very difficult words." Justice Holmes dissenting in *Northern Securities Co.* v. *United States*, 193 U. S. 197, 400, 24 S. Ct. 436, 468.

It is not for petitioner to say that this is a great case. It seems obvious, however, that the fact of three opinions upon the issues in this case all seeking ways and means to avoid coming to grips with the real issue in the case, the effect of the statutory policy laid down by Congress in the Securities and Exchange Act of 1934, indicates most strongly a distortion of judgment and unwillingness to find the meaning of not very difficult words.

The failure of the Court of Appeals in its turn to meet

the issue herein and its disregard of "abstract and formal concepts of contract law" when these concepts are the product, not of judicial policy, but of deliberate legislative intent, calls for this Court to exercise that discretion intended to insure that federal policy be not only uniform but correct.

Respectfully submitted,

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